Nos. 8850 and 8851

United States Circuit Court of Appeals

For the Sixth Circuit

JAMES A. RHEINSTROM, Executor under the Will of MINNA W. RHEINSTROM, deceased,

Appellant,

vs.

THOMAS J. CONNER, Collector of Internal Revenue,

Appellee,

and

FIRST NATIONAL BANK, Cincinnati, Ohio, Trustee under the Will of KARL KIEFER, deceased,

Appellant,

vs.

THOMAS J. CONNER, Collector of Internal Revenue,

Appellee.

BRIEF FOR THE APPELLANTS

On Appeal from the District Court of the United States for the Southern District of Ohio, Western Division.

Jerome Goldman,
Thomas C. Lavery,
Cincinnati, Ohio,
Attorneys for Appellants.
A. Julius Freiberg,
Cincinnati, Ohio,
Of Counsel.

Francis C. Canny,
United States Attorney,
Frederic W. Johnson,
Assistant United States Attorney,
Cincinnati, Ohio,
Attorneys for Appellee.

FILED
MAR 1 - 1941
JOHN W. MENZIES
CLERK

Court Index Press, Inc. - Law Printers - Cincinnati, Ohio.

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FIRST NATIONAL BANK, Cincinnati, Ohio, Trustee under the Will of KARL KIEFER, deceased,

Appellant,

vs.

THOMAS J. CONNER, Collector of Internal Revenue,

Appellee.

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF OHIO, WESTERN DIVISION.

BRIEF FOR THE APPELLANTS

THE CASE BELOW.

Appellants are taxpayers and sued appellee below to recover back income taxes paid for the calendar year 1934 on

their proportionate shares of a fund of $122,000.00 paid out by the Karl Kiefer Machine Co. during that year. The cases were tried without a jury before the Hon. John H. Druffel, District Judge, who gave judgment to appellee in both cases and rendered an opinion which will be found in the record, R. 60-67, and which is reported in 33 F. Supp. 917 (1940). The cases were considered together below, and to save repetition will be presented together in this Court.

QUESTION PRESENTED.

Whether the fund of $122,000 paid by The Karl Kiefer Machine Company to appellants and other stockholders in 1934 represented a return of capital not taxable under the Sixteenth Amendment to the Constitution of the United States and tax free under the provisions of Section 115 (c), (d), and (i) of the Revenue Act of 1934, or constituted income within the meaning of that Amendment and taxable as such under the provisions of Section 115 (a) and (b) of that Act.

STATUTES INVOLVED.

The statutes involved will be found in the Appendix, infra, pp. 39, 40, 41 and 42.

STATEMENT OF FACTS.

The Karl Kiefer Machine Company is a corporation organized in the year 1908 under the laws of the state of Ohio (R. 14). At the time the company was organized it had an authorized capital of $500,000, of which $300,000 consisted of 3000 shares of common stock of a par value of $100.00 per share, and $200,000 consisted of 2000 shares

of preferred stock of a par value of $100.00 per share (R. 14). From the date of the organization of the company and until November 30, 1914, 1500 shares of the common stock and 420 shares of the preferred stock were fully paid up, issued and outstanding (R. 15).

Prior to November 30, 1914, Minna W. Rheinstrom was the beneficial owner of 750 shares of the outstanding common stock of the company (R. 15), while Karl Kiefer was the beneficial owner of the remaining 750 shares of the outstanding common stock and all of the outstanding shares of preferred stock, 420 shares, of the company (R. 43, Pl. Ex. 10).

On November 28, 1914, at a special meeting of the stockholders of the company, at which all its outstanding stock was represented, it was unanimously agreed that the capital stock should be reduced from $500,000 to $70,000, to consist of $42,000 preferred stock divided into 420 shares at $100 each, and $28,000 common stock divided into 280 shares at $100 each (R. 15), and the president of the company was authorized to take the necessary action to make the reduction effective (R. 15). On November 30, 1914, the board of directors of the company approved the action of the stockholders and likewise authorized the president to take the necessary steps to bring about the reduction (R. 16). Thereafter a certificate of reduction of capital stock was filed in the office of the Secretary of State, Columbus, Ohio, and on December 1, 1914, that officer issued his certificate showing that the reduction of the capital stock of the company had been made and recorded in his office (R. 17, 18).

Upon the filing of the certificate of reduction of capital stock, certificates representing 1496 shares of common stock of the Karl Kiefer Machine Co. including 748 shares each owned by Minna W. Rheinstrom and Karl Kiefer,

were delivered to the company and cancelled; new certificates for 276 shares of common stock of the par value of $100.00 each were issued by the company, certificates for 138 shares thereof being issued to Mrs. Rheinstrom, and a like number to Karl Kiefer (R. 18). The remaining four shares of the 280 shares of reduced common stock were beneficially owned, two shares each, by Mrs. Rheinstrom and Karl Kiefer, but were in the name of other persons to qualify them as directors. Thus Mrs. Rheinstrom and Karl Kiefer each was the beneficial owner of one-half of the common stock both before and after the reduction of capital, each returning a net of 610 shares of common stock for cancellation to the corporation. Karl Kiefer owned the entire outstanding preferred stock, namely 420 shares both before and after the reduction in capital (R. 83).

The minutes of the meetings of the stockholders and directors of the Karl Kiefer Machine Company which record the action by which the reduction of its capital stock was accomplished are silent as to the motive which led to the taking of this action (R. 15, 16). They do record, however, that at the meeting of the stockholders and also at the meeting of the board of directors the motion to have the stock reduced was made by James A. Rheinstrom, a stockholder and secretary of the company (R. 15, 16).

Karl Kiefer died on April 16, 1931, and under the provisions of his will, appellant, the First National Bank as Trustee was left one-third of his estate in trust to pay the income thereof to Adele Kiefer for life, and on her death to pay the principal to designated remaindermen (R. 84).

In 1934 in addition to paying to its stockholders as declared dividends from earnings on common stock the sum of $90,000.00, the Karl Kiefer Machine Co. paid to

Mrs. Rheinstrom and to the legatees of Karl Kiefer the sum of $122,000.00, which it considered was in re-payment for the cancellation of the 1220 shares of common stock (Pl. Exs. 5, 6-A, 6-B, 7), of which $61,000.00, representing the 610 shares of her $100.00 par value common stock which had been cancelled, was paid to Mrs. Rheinstrom, and $20,333.33 or one-third of the $61,000.00 due Karl Kiefer for his 610 shares of similar stock, was paid to the bank as trustee under the will of Karl Kiefer (R. 14, 84-5).

When Minna W. Rheinstrom and the trustee bank received the sum of $61,000.00 and $20,333.33 respectively from the Karl Kiefer Machine Co. in 1934, they did not regard it as income; on the contrary they considered it as return of capital, that is, repayment by the company of the capital which had been used to purchase the common stock which they had owned and surrendered in 1914 pursuant to the resolutions heretofore referred to (R. 14-18, R. 80-85). Thereafter, however, appellee required them to file amended returns so as to include those sums as income for the year 1934 (R. 14, 85). It is with respect to the legality of this action under Section 115 of the Revenue Act of 1934 that these cases arise.

STATEMENT OF POINTS TO BE URGED.

I. When Mrs. Rheinstrom and Karl Kiefer each surrendered 610 shares of their common stock of the par value of $100 each to The Karl Kiefer Machine Company in 1914, and they were cancelled by the company, it was expressly understood by all the parties concerned that the company would repay the shareholders, upon demand, the paid-in surplus created by the reduction of the capital stock; and the payment of the $122,000 in 1934

by the company was to discharge the obligation created by the surrender of the stock and, therefore, was a return of capital not taxable under the Sixteenth Amendment to the Constitution of the United States and the provisions of Section 115 of the Revenue Act of 1934, passed pursuant thereto.

A. The Court Erred in Rejecting Parol Evidence of such understanding.

II. Without regard to any express understanding between The Karl Kiefer Machine Company and its stockholders, by operation of law the company became obligated in 1914 to repay to the stockholders *pro rata* the paid-in surplus created by the surrender and cancellation of the 1220 shares of common stock of the par value of $100 each; and the payment of the $122,000 to discharge this obligation, constituted a return of capital and as such was not subject to income taxation under the Sixteenth Amendment to the Constitution of the United States and the provisions of Section 115 of the Revenue Act of 1934, passed pursuant thereto.

III. The payment of the $122,000 was for the cancellation of 1220 shares of common stock, and was a distribution in partial liquidation as defined by the Section 115 of the Revenue Act of 1934. It was properly chargeable to capital account and was made free from the imposition of income tax by that very section of the act.

I.

The Distribution by a Corporation of the Surplus Created by the Surrender by a Shareholder of his Shares of Stock for Cancellation, Pursuant to an Express Agreement, is a Return of Capital and not an Income Producing Transaction.

When, in 1914, Mrs. Rheinstrom and Karl Kiefer each surrendered 610 shares of common stock of The Karl Kiefer Machine Company for cancellation and thereafter the company, pursuant to corporate action approved by the Secretary of State of Ohio, cancelled such shares without at that time repaying their par value, some purpose must have been intended. It is appellant's contention that the actual understanding between the company and the stockholders in 1914 was that the company should repay to the stockholders the capital which had been paid in for the 1220 shares of stock whenever they should make a demand for payment, and that the payment made in 1934 was in fulfillment of this obligation.

Although the minutes and records of the company unequivocally show that the capital stock of the company was reduced, that 1220 shares of fully paid-up common stock were returned to the company and cancelled (R. 18), and that a paid-in surplus was thereby created, they do not show the purpose for which this corporate action was taken (R. 15, 16). Fortunately, the appellant was able to produce at the trial of this case in the District Court a witness who had personal knowledge of the motive which inducted the stockholders to surrender their stock in 1914 and of the intention of the company to repay the capital which the shares represented in their hands (R. 28). That witness was James A. Rheinstrom,

the only surviving stockholder and director of the company, who in 1914 was secretary of the company, was present at the stockholders' and directors' meeting at which the resolutions calling for the reduction of the capital stock of the company were adopted, and who in fact moved the adoption of those resolutions (R. 15, 16). Mr. Rheinstrom was thus in a position to testify from his own observation and recollection as to the understanding between the company and its shareholders which culminated in the events referred to.

However, when Mr. Rheinstrom took the witness stand and was asked to state the facts which prompted the adoption of the resolutions leading to the reduction of the capital stock of the company and the purpose of such reduction, the District Court, upon objection by counsel for the appellee, refused to permit him to answer on the ground that the testimony he was about to give would, if received, violate the parol evidence rule (R. 30). Although counsel for the appellant pointed out to the Court that the grounds upon which the objection was based were not well taken (R. 30), the Court nevertheless adhered to its view that the testimony offered was inadmissible and sustained the appellee's objection, thus excluding the testimony of the only living person who had personal knowledge of the facts upon which the single issue of the case depends.

A. The Court Erred in Rejecting Parol Evidence of such Understanding.

The action of the District Court in refusing to permit Mr. Rheinstrom to testify was, it is submitted, erroneous on at least three grounds. (1) The Parol Evidence Rule can be taken advantage of only by the parties to an

instrument and their privies, but it is of no avail to third parties as the appellee here. (2) Corporate minutes do not constitute the type of instrument to which the Parol Evidence Rule applies. (3) The Parol Evidence Rule does not exclude testimony of the background or purpose of the parties in executing an instrument.

Rule 43 (a) of the Rules of Civil Procedure for the District Courts of the United States provides in part as follows:

> " * * * All evidence shall be admitted which is admissible under the statutes of the United States, or under the rules of evidence heretofore applied in the courts of the United States on the hearing of suits in equity, or under the rules of evidence applied in the courts of general jurisdiction of the state in which the United States court is held. In any case, the statute or rule which favors the reception of the evidence governs and the evidence shall be presented according to the most convenient method prescribed in any of the statutes or rules to which reference is herein made."

The cast of subdivision (a) of Rule 43 is obviously toward admissibility, not exclusion, *Moore's Federal Practice Under the New Federal Rules,* Section 43.02 (1938), and when a point of admissibility is raised, if the evidence is admissible under the rules of evidence applied in the courts of general jurisdiction of the state in which the federal court is held, the evidence should be admitted. It is only when the law of that state is opposed to admissibility that other sources of authority should be sought.

But if, notwithstanding the clear language of Rule 43 (a), any doubt had remained about the matter, it is dispelled by the decision of the Supreme Court of the

United States in *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938), overruling *Swift* v. *Tyson*, 16 Peters 1, 10 L. Ed. 865 (1842), in which it was held that the local state law must be followed when the problem before the court is not governed by federal statute. It follows, therefore, both by the decision of the Supreme Court and the unambiguous language of Rule 43 (a) that where the testimony sought to be adduced is admissible under the law of the state in which the federal court is held, it should be admitted by that court.

(1) Under the law of Ohio, the testimony which the appellant sought to introduce is admissible. In *Platt* v. *Huron County Banking Company*, 50 Oh. St. 528, 35 N. E. 308 (1893), the court said:

> "As a general rule, it is not competent to vary the terms of a written instrument by parol testimony. But this applies only to controversies between the parties to the instrument and their privies. In a suit between third persons, strangers to the instrument, or between a party to the instrument and a stranger, such evidence is admissible."

See also *Jones, Commentaries on Evidence*, 2d Edition, §1488, where it is said:

> "The parol evidence rule is limited to the parties to the contract or writing or their privies. Therefore when the controversy is between a party to a written contract and one who is neither a party nor a privy to it, the rule which the courts usually refer to as 'excluding parol evidence tending to vary, modify or contradict the writing' does not apply."

Neither the appellee nor the United States was a party to the action taken by the stockholders and directors of

The Karl Kiefer Machine Company in 1914 and, therefore, it is submitted that, even if the parol evidence rule were otherwise applicable in this case, as third parties to the transaction, they could have no valid ground of objection on that score.

In a situation which closely parallels that at bar, the Supreme Court of Ohio, in *Bowman* v. *Tax Commission, et al.*, 135 Oh. St. 295, 16 N. E. (2d) 459 (1939), reaffirmed the rule of the *Platt* case. There the Tax Commission of Ohio had objected to the admission of parol testimony relating to the character, form and operation of certain insurance contracts. In holding the evidence admissible, the Court said:

> "While parol evidence may not be received to contradict or vary the terms of a written instrument as between the parties thereto and those claiming under them, such evidence is admissible when otherwise competent in controversies between strangers to the instrument, or between a stranger and a party thereto."

(2) However, even though it be assumed that the appellee was a party to the transaction, which clearly he was not, there is authority for the proposition that the testimony offered would not have been offensive to the parol evidence rule, since the minutes of the stockholders' and directors' meetings are not the kind of writings toward which that rule is directed. In order for a writing to come within the operation of the rule governing the admission of extrinsic evidence it must be of a contractual nature or definitive of the rights of the parties. 17 O. Jur. 565, Sec. 458. The minutes in this case are neither contractual nor definitive of such rights; they are merely a summary record of what transpired at the

meetings of the stockholders and directors,—a short and simple account of ultimate facts.

On this point, *Lawrence* v. *Premier Indemnity Insurance Company, et al.*, 180 Cal. 688, 182 Pacific 431 (1919), is strikingly apposite. In that case, for the purpose of showing plaintiff's ownership of stock, there were introduced on his behalf, among other things, the minutes of a stockholders' meeting. The defendant offered parol testimony contra to the effect that the minutes did not show the real transaction and understanding, and that the stock was to be the plaintiff's only on certain conditions. The plaintiff objected on the ground that such testimony was incompetent under the parol evidence rule as varying the terms of the written insrtument, to-wit, the minutes of the meeting. The Supreme Court of California held this objection not well taken, saying:

> "Plaintiff's counsel contend that testimony showing that something took place at the meeting other than is shown by the minutes is not admissible under the 'parol evidence' rule. But minutes of a meeting are not a written instrument. Their function is merely to act as a written record of what took place at the meeting. That record may be true or it may not be, and in the absence of the element of estoppel, it is permitted to the corporation or to anyone else to show what actually did take place at the meeting."

See also, *Daggett* v. *St. Paul Tropical Development Company*, 141 Minnesota 51, 169 N. W. 252 (1918); *Cook* v. *Manasquan*, 80 N. J. L. 206, 76 Atl. 310 (1910), *Butts* v. *Gaylord State Bank*, 156 Misc. 555, 282 N. Y. S. 1 (1935).

(3) Apart from authority, however, it is submitted upon sound legal principles, that the testimony of Mr. Rheinstrom should have been admitted. As the proffer made

at the trial shows (R. 31-33), his testimony would have disclosed the purpose of the action of the stockholders and directors of The Karl Kiefer Machine Company in reducing the capital stock and in the return and cancellation of the 1220 outstanding shares of common stock. There was nothing in the testimony he was about to give which would have even remotely tended to contradict or vary the tenor of the minutes for the reason that they contain nothing whatever to denote the underlying purpose of the transaction. On the contrary, the need for his testimony was imperative since without it there was no way in which the decisive facts upon which the issue of the case depends could be ascertained.

It is a general rule, not only in Ohio, but elsewhere, that the surrounding circumstances leading up to the execution of any written instrument, and particularly the purpose of the parties in executing such instrument, may be shown by extrinsic parol evidence. Thus, in *Third National Bank* v. *Laidlaw*, 86 Oh. St. 91, 100, 98 N. E. 1015 (1912), the Court said:

> " • • • evidence of the surrounding circumstances is competent in order to arrive at the intention of the parties."

See also *Merchants National Bank* v. *Cole*, 83 Oh. St. 50, 93 N. E. 465 (1910); *Morgan* v. *Boyer*, 39 Oh. St. 324, 48 Am. Rep. 454 (1883); and *Rorick* v. *Gilbert*, 45 Oh. App. 96, 186 N. E. 756 (1931). This principle was also confirmed in the *Bowman* case, *supra*, by the Supreme Court of Ohio, and by the Supreme Court of the United States in *Brick* v. *Brick*, 98 U. S. 514, 25 L. Ed. 256 (1878), where it was said that

> "The rule which excludes parol testimony to contradict or vary a written instrument has reference to the language used by the parties. • • •

> The rule does not forbid an inquiry into the object of the parties in executing and receiving the instrument."

When the District Court sustained the objection to the testimony which Mr. Rheinstrom was about to give, counsel for the appellant thereupon made a proffer as to what he would have said (R. 31), had he been allowed to testify. As indicated in the record (R. 31, 32, 40, 41), his testimony would have shown that it was the understanding of all the parties to the reduction of the capital stock of The Karl Kiefer Machine Company that the capital which had been used by the stockholders to pay for the shares for which they had subscribed, to-wit, $100 per share, should be repaid to them at any time demand for repayment was made. When, therefore, in 1934, the company paid out the $122,000, which it had expressly agreed to repay by reason of the surrender and cancellation of the 1220 shares, Mrs. Rheinstrom and the legatee of Karl Kiefer received merely a return of the original capital investment, an amount equal to that originally paid in for the cancelled shares. Thus, the entire transaction was a capital transaction from which they realized no income upon which a tax could be imposed by the Revenue Act of 1934, within the limitations of the Sixteenth Amendment, or was intended to be imposed by that Act.

II.

When a Shareholder Surrenders Shares of Capital Stock to a Corporation for Cancellation, the Corporation, if its Capital is Unimpaired, Becomes Obligated as a Matter of Law, to Repay to such Shareholder the Paid-In Capital Which the Shares Represent and Which is Made Free by the Cancellation.

The appellant further contends that even in the absence of an express understanding between the parties that The Karl Kiefer Machine Company was to repay an amount equal to the par value of the common stock surrendered by Mrs. Rheinstrom and Karl Kiefer for cancellation, the duty to repay that amount was created by operation of law in 1914 when the surrender and cancellation occurred. It is a general rule of the law of corporations that the price paid by the subscribers to the capital stock of the corporation for their shares belongs to the corporation and that the certificate of stock issued to the stockholders merely evidences their right, *inter alia,* to participate in the distribution of its earnings, if, as, and when dividends are declared by the board of directors, and to share *pro rata* in the distribution of the assets of the corporation when its affairs are wound up. In other words, a stockholder has no interest in the assets *eo nomine* of the corporation. When, however, a corporation whose capital is unimpaired determines to liquidate in whole or in part, its relationship to its stockholders with respect to its assets undergoes a change. In the absence of creditors, a corporation, in accordance with its by-laws, and with the approval of the Secretary of State, may redeem all or a part of its shares, and pay for them by a distribution of its assets, either in cash or in property; and the

redemption and cancellation of the shares of stock of any stockholder, when the corporation does not pay the redemption price at once, *ipso facto* creates a debt in favor of the stockholder, and his relationship to the company is thereby transformed from stockholder to creditor.

That such a change in the legal position of a stockholder occurs upon the reduction of the capital stock of a corporation, in whole or in part, when the stockholder surrenders his stock for cancellation and is not thereupon repaid the equivalent of its par value, is uniformly recognized by the courts. A leading case on this subject is *Jerome* v. *Cogswell*, 204 U. S. 1, 27 S. Ct. 236, 51 L. Ed. 345 (1907). In that case the directors of a national bank having a capital stock of $300,000, by appropriate action of the stockholders and directors, reduced its capital to $200,000. The stockholders thereupon surrendered their certificates representing the shares of the original capital in return for two-thirds of the number of shares originally held. Some years later, when the charter of the bank expired, and while its affairs were being wound up in the manner provided by law, a question arose as to whether the proceeds of the surplus of assets resulting from the reduction of the capital and cancellation of the excess shares of stock should be distributed to the stockholders of record at the time the reduction was made, or at the time the charter expired. The stockholders of record at the time the reduction was made, who had in the meantime transferred their shares, claimed that they had a right to share in the surplus created by the reduction of the capital, that they became creditors of the corporation to that extent upon the reduction, and that this surplus was not part of the corporation's assets to be divided among the persons who happened to be shareholders at the time of the dissolution.

The Supreme Court of the United States held in favor of the stockholders of record at the time of the reduction of the capital stock occurred, and thereby declared the law by which the case at bar is governed. It said (at page 7):

> "As a general rule it may be admitted that where capital stock is impaired and a reduction is made merely to meet that impairment, there can be no distribution. But that is not this case, in which the stockholders of record June 9, 1900 (the date when the capital was reduced), *had a right to require a distribution among them of an excess upon reduction in proportion to their respective holdings.* In the language of the Connecticut Supreme Court: 'The right to receive what might ultimately be realized from the fund thus set apart became therefore irrevocably vested in those who were stockholders on June 9, 1900, and they or their assigns are now entitled to whatever is to be distributed from it'." (Matter in parenthesis and italics added.)

The validity of the appellant's assertion that Mrs. Rheinstrom, upon the surrender and cancellation of her stock, ceased to be a stockholder to that extent and became a creditor of The Karl Kiefer Machine Company to the extent of the par value of the stock cancelled, is further strengthened by the holding of the Supreme Court that the right to receive payment for the shares cancelled vests irrevocably in the shareholder of record at the date of the cancellation, and is not affected by the fact that thereafter the shareholder transfers his shares to a third party. On this point the Court said (at page 8):

> "It follows as held that the transfer of shares after the reduction of June 9, 1900, did not carry any right to an interest in the special trust fund, the proportionate interest therein having vested

> in the then-shareholders as individuals. The result is unaffected by the fact that distribution in cash may have been contemplated as the assets set aside were realized upon."

The holding of the Supreme Court of the United States in the *Jerome* case has been followed by every court which has had occasion to pass upon the question. Thus, in *Continental Securities Co.* v. *Northern Securities Co.*, 66 N. J. Eq. 274, 57 Atlantic 876 (1904), a corporation reduced its capital and proposed to pay to its shareholders the surplus created by the reduction, whereupon an injunction was sought to prevent the execution of the plan. In denying the injunction the Court said:

> "By the reduction of the capital stock of a corporation, not impaired by losses, there must necessarily occur a surplus of assets to the extent of the reduction; and unless the rights of creditors will be affected thereby, or the capital impaired, it becomes the duty of the directors to make an equitable distribution of such surplus, * * *. The proposed distribution is not a dividend, in the sense intended by the statute, but a division of surplus capital rendered useless for the purpose usually attributable to capital, because the issue of stock which it represented has been canceled."

In *Seeley* v. *New York National Exchange Bank of New York*, 8 Daly (N. Y.) 400, affirmed without opinion 78 N. Y. 608 (1879), the Court held that where a company reduces the amount of its capital stock, it must return to the stockholders the whole of the capital set free by such reduction, and cannot retain a portion of it for use as a surplus fund or for other purposes. In rejecting the contention that it was discretionary with the directors either to return the money to the shareholders or to retain

it for use by the company, since by retaining it the company would do no injury to the shareholders inasmuch as the shares would increase in market value as they diminished in number and therefore the shareholders would own the same proportionate interest in the corporation as before, the Court said:

> "It is true that his proportion of the capital stock will relatively be as great as before the reduction; but it is altogether matter of conjecture as to the future market value of a share of the reduced stock. The return of the reduced capital to the shareholder is not, however, a subject for the exercise of a director's discretion.
>
> "If the retired capital be a liability of the corporation in favor of the shareholders who give up the stock that is called in, the payment of that debt cannot lie in any man's discretion. Payment cannot be deferred because the directors believe it for a creditor's advantage to keep him out of his money.
>
> "When a dividend has once been declared, the directors cannot afterwards refuse to pay it, because they have determined to establish a surplus fund with a view to benefit the corporation and its stockholders. The dividend, when declared, becomes a debt, and cannot thenceforth be disposed of without the consent of him who is entitled to it. * * * It would be strange if capital—capital which has accomplished its mission—could be diverted from its owners, and used against their protest to build up a surplus fund, when even a dividend, once declared, cannot be."

To the same effect see *Roberts* v. *Roberts-Wicks*, 92 N. Y. S. 387 ( ); *In re Artisans Land and Mortgage Corporation* (1904), L. R. 1 Chancery 796; 5 *Thompson on Corporations*, 3d Ed., §3695; 5 *Fletcher's Cyclopoedia of*

Law of Private Corporations, Vol. 5, §3472; 1 *Morawetz on the Law of Private Corporations,* 2d Ed., §443.

On the authority of the decision of the Supreme Court of the United States in *Jerome* v. *Cogswell,* supra, the decisions of the state courts, and the text writers heretofore referred to, it is submitted that by operation of law it became the duty of The Karl Kiefer Machine Company to repay to its shareholders the $122,000 surplus created by the reduction of its common stock from $150,000 par value to $28,000 par value in 1914; that Mrs. Rheinstrom and Karl Kiefer, as the owners of one-half each of the stocks surrendered and cancelled, thereupon became each entitled to one-half of that sum; that since the cost of the stock when it was issued and the amount to which they were entitled when the stock was called in and cancelled, was the same, viz: $122,000, or $61,000 each, when the Company in 1934 paid Mrs. Rheinstrom and the legatees of Karl Kiefer that amount, no gain or loss resulted, and no income subject to taxation under the provisions of the Revenue Act of 1934 was realized from the transaction.

In the court below counsel for appellee based his entire case, and the decision of the Court below was likewise based upon the assumption that the reduction in the capital stock of The Karl Kiefer Machine Company and the cancellation of the 1220 shares of stock was only a bookkeeping transaction; and that in reality the relation of the parties with respect to each other and to the corporation remained unchanged by reason of changes in its capital structure. (See Findings and Conclusions of the Judge below, R. 63, 65, 66).

In this contention counsel for the appellee and the District Court fell into error due to a misapprehension of fact on their part. That error lies in their assumption that Karl Kiefer and Mrs. Rheinstrom must be treated

as if each owned one-half of all the capital stock of The Karl Kiefer Machine Company, both common and preferred, whereas the fact was that prior to and subsequent to the reduction of the common stock there were outstanding 420 shares of preferred stock of the par value of $100 each, all of which were owned by Karl Kiefer, and Mrs. Rheinstrom owned no preferred stock whatever in the Company (R. 83).

The nature of the preferred stock in The Karl Kiefer Machine Company, owned in its entirety by Karl Kiefer, is indicated by the Company's Articles of Incorporation:

> "The Capital Stock of said corporation, common and preferred shall be Five Hundred Thousand Dollars ($500,000), consisting of Three Thousand (3000) shares of Common Stock of the par value of One Hundred Dollars ($100) each, and two thousand (2000) shares of Preferred Stock of the par value of One Hundred Dollars ($100) each; and the holders of the preferred stock shall be entitled to a dividend of six per cent per annum, payable quarterly, out of the surplus profits of the company for each year in preference to all other stockholders and such dividends shall be cumulative. The holders of said preferred stock shall not have the right to vote." (Def's Ex. A)

This excerpt from the Articles of Incorporation shows that the shareholders of the company, both common and preferred, stood on equal footing with the exception of a preference as to the payment of dividends and a limitation upon their voting privilege. Thus, the *right of the holder of the preferred stock to share in the assets of the company upon dissolution was not in this case circumscribed by a provision,* ordinarily found in such shares, *restricting the holder thereof to a return of their par*

value plus accumulated dividends upon distribution of the assets of the company on dissolution. The par value of each class of stock in The Karl Kiefer Machine Company, common and preferred, was $100 per share, and each share thereof represented precisely the same fractional capital interest in the company.

In this situation, upon a distribution of the assets of the corporation, the preferred and common stockholders would together divide the surplus in proportion to the number of shares of each. In *Continental Insurance Co., et al.,* v. *United States, et al.,* 295 U.S., 156, 181, 66 L. ed. 871, 888 (1922), the common stockholders claimed the entire surplus of a corporation upon dissolution, to the exclusion of the preferred. The United States Supreme Court rejected this claim and restated the well established rule that where there is no restriction stated in the Articles or Charter on the preferred stock's right to share upon dissolution, the preferred had an equal right with the common to share in the surplus on dissolution.

There being no restriction on the preferred's right to share in the present case, the same rule applied. Accordingly, Mrs. Rheinstrom's and Karl Kiefer's respective proportionate share of the assets of the corporation to which they would have been entitled upon dissolution, before and after the reduction in capital, respectively, is shown by the following tabulation:

BEFORE REDUCTION IN CAPITAL

	Common Stock Shares	Preferred Stock Shares	Total Common and Preferred	Proportion of Holdings to Total.
Mrs. Rheinstrom	750	0		$\frac{750}{1920} = 39\% = 2/5$
			1920	
Karl Kiefer	750	420		$\frac{1170}{1920} = 61\% = 3/5$

AFTER REDUCTION IN CAPITAL

	Common Stock Shares	Preferred Stock Shares	Total Common and Preferred	Proportion of Holdings to Total.
Mrs. Rheinstrom	140	0		$\frac{140}{700} = 20\% = 1/5$
			700	
Karl Kiefer	140	420		$\frac{560}{700} = 80\% = 4/5$

Thus Mrs. Rheinstrom's proportionate ownership in the company was reduced from two-fifths to one-fifth, or cut completely in half by the reduction in capital and cancellation of the 1220 shares of common stock, whereas Karl Kiefer's share was increased from three-fifths to four-fifths. In addition to this very material change in their proportionate shares upon dissolution, the reduction in capital likewise caused vital changes in other rights of Mrs. Rheinstrom and Karl Kiefer as stockholders. Whereas the preferred stockholders could not vote at ordinary stockholders' meetings, they still had the right under the law to vote on complete liquidation where a three-fourths vote of all the stockholders, including the

preferred, was necessary (*Rev. Statutes of Ohio, Sec. 3256c; 98 Oh. Laws 230*). The reduction in capital, as it gave Karl Kiefer four-fifths of all the stock, whereas previously he had had only three-fifths, likewise gave him control of determining when the corporation should be completely liquidated.

In view of this situation is it conceivable that the intention of the parties could have been other than that proffered by the witness, i.e. to make the capital freed by the reduction and the cancellation of the 1220 shares callable on demand by the stockholders whose shares were cancelled? Otherwise Mrs. Rheinstrom would have given up for no consideration at all an entire one-half of her interest in the company to Karl Kiefer, with the further right on his part to say when he should take it.

The learned Judge below, however, erroneously rejected this showing that Mrs. Rheinstrom's interest in the company was reduced from two-fifths to one-fifth and Karl Kiefer's increased from three-fifths to four-fifths, because, contrary to the decision in the *Continental Insurance Company* case, *supra*, he ignored completely the fact that under the law the preferred stock had equal rights with the common to share in the surplus upon dissolution (See R. 63). In this we submit he fell into serious error that resulted in an entire misconception of the case, which was further aggravated by the erroneaus exclusion of the proffered testimony above mentioned.

III.

Section 115 of the Revenue Act of 1934 does not Sanction the Imposition of the Federal Income Tax upon Corporate Distributions in Payment of the Cancellation of Stock or Other Distributions Properly Chargeable to Capital Account.

It has been the appellant's contention throughout this brief that the surrender of the 1220 shares of common stock of The Karl Kiefer Machine Company in 1914 was the beginning and the payment of the $122,000 by that company in 1934 was the end of the single transaction necessary to constitute performance of the express agreement which underlay the resolutions passed by the stockholders and directors at their meetings in November, 1914, and to carry out the company's obligation as a matter of law regardless of any express agreement. The parties to this proceeding agree that the stock was surrendered and cancelled in 1914 and they agree that the company paid the $122,000 in 1934. The only point on which they disagree is whether the payment made in 1934 was a return of the Rheinstrom and Kiefer capital investment or whether it was the distribution of a dividend. The appellant asserts that on the facts proved or provable under the rules of evidence the payment made by the company in 1934 was to discharge its obligation to repay the capital invested in the stock which was surrendered and cancelled. The only question remaining for consideration is whether Congress in Section 115 of the Revenue Act of 1934 sanctioned the imposition of the income tax upon a payment so made.

Section 115 (c) of the Revenue Act of 1934 provides in part that

> "Amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. * * *
>
> "In the case of amounts distributed, whether before January 1, 1934, or on or after such date in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distribution by the corporation",

and in subsection (i) of the same section the phrase "amounts distributed in partial liquidation" is defined to mean

> "a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

Section 115 (d) provides as follows:

> "*Other distributions from capital.* If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in Section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property."

It is obvious from Section 115, paragraphs (c) and (d), that Congress intended that distributions could be made which were properly chargeable to capital account free

from tax irrespective of paragraphs (a) and (b) of the same section, and that Congress did not intend paragraphs (a) and (b) of that section to create a conclusive presumption which would render a capital distribution income for the purposes of taxation. As will be shown hereafter, it is beyond the constitutional authority of Congress to attempt to define income to be taxable within the Sixteenth Amendment so as to embrace distributions which are in a real sense capital and not income. In short, Congress can not by definition make capital income. Of course it must therefore be presumed that Congress did not intend to do what it had no power to do.

Manifestly the above quoted provisions were intended by Congress to permit a corporation partially to liquidate its outstanding shares of stock without reference to the provisions of the other subsections of Section 115, subject only to the determination of gain or loss from such liquidation and distribution under the provisions of Section 111, of the Act. See *House Reports, 68th Congress, First Session, Vol* 1, *Reports,* 179, page 11; *Senate Reports, 68th Congress, Vol.* 1, *1st Session, Rep.* 398, pages 11 and 12; *House Reports, 68th Congress, First Session, Vol.* 4, *House Report* No. 844. page 14.

While a casual reading of the language used by Congress in Section 115(c) of the Revenue Act of 1934 dispels any doubt about its intention to exclude from income distributions in complete cancellation or redemption of all or a part of the stock of a corporation, that conclusion is confirmed by a consideration of the cases in which current earnings have been used by the corporation to reimburse a stockholder for his capital investment allocated to stock issued as a stock dividend, and in which the contention of the Government has been that such cancellation and redemption was part of a scheme to dis-

tribute current earnings of the corporation in the guise of a partial liquidation of the stock. Thus, in *Brown* v. *Commissioner*, 69 F. (2d) 602 (1934), certiorari denied sub nom. *Helvering* v. *Brown*, 293 U. S. 570, 55 S. Ct. 81, 79 L. Ed. 669 (1934), where part of a stock dividend issued by the corporation in 1922 was redeemed and paid for in 1925 when the company had earnings accumulated since February 28, 1913, on hand sufficient in amount to make the payments, and the Commissioner claimed that the distribution was a taxable dividend, the Court held that it should be treated as a payment in exchange for the stock and therefore properly chargeable to the capital account. Likewise, in *Commissioner* v. *Babson*, 70 F. (2d) 304 (1934), certiorari denied sub nom. *Helvering* v. *Babson*, 293 U. S. 571, 55 S. Ct. 107, 79 L. Ed. 669 (1934), where substantially the same problem was involved and the Government contended that Congress intended to tax as a dividend every distribution by a corporation of earnings accumulated after February 28, 1913, unless the distribution were in the form of a stock dividend, or unless the amounts were distributed in complete liquidation of the corporation, the Court said that a bone fide distribution in liquidation should not be considered as a taxable dividend. See also *Commissioner* v. *Rockwood*, 82 F. (2d) 359 (1936), where the Court said:

> "We believe that whatever may have been the intent of the company in accumulating and conserving profits for several years, unless there is some evidence to show that the retirement of preferred stock therefrom was previously conceived with intent of evasion, the normal situation exists, and we have merely a return of invested capital."

Commissioner v. *Ahlborn*, 77 F. (2d) 700 (1935); *Commissioner* v. *Cordingley*, 78 F. (2d) 118 (1935).

In several of the cases referred to, the contention was made by the Government that a distribution cannot be in partial liquidation under Section 115(c) of the Revenue Act of 1934, unless the corporation at the time is planning a cessation of business or is in the process of final liquidation. But the Court, in *Commissioner* v. *Quackenbos*, 78 F. (2d) 156 (1935), found it hard to perceive the force of such a contention, saying:

> "A redemption of a part of the stock of a corporation, whether it be of all of a class such as of preferred stock, or of a part of the common stock, has no necessary relation to the winding up of the corporation."

This case was followed in *Patty* v. *Helvering*, 98 F. (2d) 717 (1938). See also *Commissioner* v. *Champion*, 78 F. (2d) 513 (1935).

From these cases, as well as from the language of the Act itself, the conclusion necessarily follows that under the various revenue acts beginning with that of 1924, any distribution in cancellation or redemption of all or of a *portion of the capital stock* of a corporation, whether originally subscribed or issued as a stock dividend *is not taxable as a dividend, regardless of the amount of earnings on hand accumulated after February* 28, 1913, *at the time of the distribution,* except where the issuance of a stock dividend and its cancellation are part of a scheme to distribute such accumulated earnings. Nor does there have to be any winding up of the corporation; it may continue in business as usual.

It has never been contended by the Government in this case that the distribution in liquidation of the stock redeemed and cancelled was part of a scheme to distribute earnings accumulated by the company since February 28, 1913, for the reason that the reduction in the capital

stock of the company and its redemption and cancellation occurred long before any one had thought of subsection (b) of the Revenue Act of 1934 or its predecessors. As heretofore pointed out, the redemption of the stock in the case at bar was upon the express understanding that the subscription price therefor would be repaid, and when it was repaid in 1934, the payment was made out of capital and not out of earnings. Under these circumstances, it was not a dividend and therefore it cannot be taxed as such.

A. The Same Distribution in the Case of Another Stockholder was Held by the Bureau to be a Return of Capital. To tax a Return of Capital Would be Unconstitutional.

The purely capital nature of the entire transaction in the case at bar is strikingly shown by the situation of appellant, The First National Bank, Trustee under the will of Karl Kiefer. It will be remembered that under Karl Kiefer's will, one-third of his estate was bequeathed to the Bank, in trust, to pay the income thereof to Adele Kiefer for life and upon her death to pay the principal to the designated remaindermen (R. 84). When the bank received one-third of Karl Kiefer's share of the $61,000, it retained the same as principal under the trust and proposed to pay Adele Kiefer only the income received on that amount for life, and to hold the principal of that sum for the benefit of the remaindermen (R. 85). Inasmuch as the payment was a capital distribution the bank could do nothing else. Adele Kiefer, recognizing that the bank's position was unassailable, made even no effort to claim the payment as income which she would have been entitled to as a life tenant had it in fact been income.

The Bank's position also has full support of the Ohio authorities. In *Cleveland Trust Co.* v. *Hickox, et al.*, 32 Ohio App. 69, the law of Ohio governing a distribution as that in the present case is set down very clearly. In that case a corporation called in and redeemed its par value stock and issued new par value stock instead, also making a cash distribution of $100 per share at the same time. Both the life tenants and the remaindermen claimed the cash distribution. The trustee asked for instructions. In affirming the lower court in its holding that the cash distribution went to corpus, the court said at pagae 80—

> "The Court can not declare a dividend or create income or earnings out of the act of the stockholders and directors in consummating the agreement authorized by the resolution, and, if the court exercised such power in the face of the fact that the deal was fully and finally consummated, it would so irrevocably confuse the situation that chaos only would result, because the old stock has been cancelled by the issue of the no par stock, and the corporation, newly organized, is operating upon a basis substantially different in legal character.
>
> If there is an exchange of corporate stock by the trustees, which in and of itself is part of the corpus, it is absolutely immaterial as to whether the other party with respect to the exchange is the corporation issuing the stock or some other party. If there is liquidation of a corporation, partial or complete, the determining element of the transaction is whether the stockholders surrender and cancel the stock which is given in exchange, and the same is true as to a partial exchange of corporate assets for new securities in case of partial liquidation."

See also, *Wilberding, Adm'r.* v. *Miller,* 90 O.S., 28, 106 N.E. 665, *Lamb* v. *Lehmann* 110 O.S., 59, *Restatement of Law on Trusts,* Section 236 (f).

To similar effect, see *In Re Opperman's Estate* (Pa. 1935) 179 Atl. 728, where the Court held that a distribution of the surplus created by a reduction in capital was principal and belonged to the remaindermen.

The United States Supreme Court supports the same principles in its analyses of capital and income.

See

Lynch v. *Turrish,* 247 U. S., 221, 62 Law Ed. 1087,
Southern Pacific Co. v. *Lowe,* 247 U. S. 330, 62 L. Ed. 1142,
Lynch v. *Hornby,* 247 U. S., 339, 62 Law Ed. 1149,
Gibbons v. *Mahon,* 136 U. S., 549, 34 Law Ed. 525,
Towne v. *Eisner,* 245 U. S., 418, 62 Law Ed. 372,
Peabody v. *Eisner,* 247 U. S., 347, 62 Law Ed. 1152,
Eisner v. *Macomber,* 252 U. S., 189, 64 Law Ed. 521.

In *Girard Trust Company, et al.,* 32 B.T.A., 926, the administrators of a trust were not sure whether the accumulated surplus of a corporation in which they held the stock belonged to the life tenants or to the remaindermen. They were afraid that if the corporation declared a cash dividend in a large amount there might be a disagreement between the life tenants and the remaindermen as to what portion, if any, of the dividend belonged to each class. To fix the rights of the parties beyond dispute, the administrators had the corporation call in and cancel $80,000 worth of its stock, and the administrators allocated the $80,000 received from the corporation for the stock to the corpus of the trust, calling it a return of capital. The Commissioner held the distribution taxable on the ground that the corporation had an adequate surplus of accumulated earnings from which

to have made the distribution, and claimed that this fact placed the distribution within Sections 115 (b) and (g) of the Revenue Act. The Board of Tax Appeals reversed the Commissioner, holding that the distribution was a return of capital and not essentially equivalent to the distribution of a taxable dividend and was therefore not taxable as such.

In the *Girard case* the stock redemption device was admittedly used to avoid the payment of a cash dividend (although not for the purpose of evading the tax), yet the distribution was deemed a return of capital allocable to the remaindermen and not taxable as dividends. Surely in the present case, where the redemption and cancellation were without intent to avoid anything, and were accomplished away back in 1914, long before any tax question ever could have been raised, the distribution to the trustee must all the more be considered a return of capital allocable to the remaindermen and not subject to tax as dividends.

In view of the clear requirement of these authorities, the bank as trustee had no choice but to hold the $20,333.33 it received from The Karl Kiefer Machine Company as part of the corpus of the trust estate. It paid no part thereof to the life tenant, Adele Kiefer. The Commissioner of Internal Revenue, however, at first, consistent with his claim here that the distribution was a dividend and therefore income, proposed to assess a tax on this payment against Adele Kiefer as she did not include it in her return. If the distribution was in fact a dividend from earnings, it was income and payable to Adele Kiefer as life tenant under the terms of the trust, in which case it was taxable to her whether the trustee actually paid it to her or not. (*See Section 162 of the*

Revenue Act of 1934 set forth in Appendix Post, p. 41) *Freuler* v. *Helvering,* 291 U. S., 35, 54 S. Ct. 308. The first syllabus of that case reads:

> "Income beneficiary of trust held required to pay tax not on so much of income as he actually receives, but on amount he should properly have received in any tax year".

Adele Kiefer protested against this proposed assessment, claiming that the distribution was capital, and that therefore under the trust she was not entitled to receive it as life tenant. Upon reconsideraion the Commissioner of Internal Revenue in a letter to her expressly conceded her contentions and revoked the proposed assessment (R. 59). Thus on Adele Kiefer's protest the Commissioner of Internal Revenue held the distribution to be capital and not income.

However, in spite of the fact that this $20,333.33 distribution was conceded by the Bureau to be capital, in respect to her upon Adele Kiefer's protest, it nevertheless claimed that as to The First National Bank as Trustee, this very same $20,333.33, which the Bank, consonant with the Bureau's ruling on Adele Kiefer's protest, was holding as capital, was income and taxable. Surely this could not be. It was either capital or income. It could not be both. This wholly inconsistent attitude on the part of the Commissioner of Internal Revenue produces this curious paradox. As the distribution was a return of capital to the trustee in so far as Adele Kiefer was concerned, the trustee clearly could not deduct any income tax it had to pay on this amount from the income of the trust payable to Adele Kiefer. For the trustee to pay the tax and charge it to the corpus, would be as egregiously unfair to the remaindermen for the remaind-

ermen would be charged with the tax on income (not capital gains) although under the trust they are not entitled to receive any income. Such a self-contradictory result just does not make good sense.

If the distribution was a return of capital which the Commissioner conceded it was, on Adele Kiefer's protest, it must have been a return of capital for all purposes. It could not be a return of capital to one stockholder and metamorphosed into income in the case of another. Obviously, since the distribution to the trustee was a return of capital, it was equally a return of capital to Mrs. Rheinstrom, another distributee of the same fund.

It is submitted that the action of the Bureau in the case of Adele Kiefer's protest clearly shows the true nature of the distribution, and the Bureau was guilty of grossly unfair inconsistency and discrimination in claiming the same distribution to be income and taxable to the Bank and Mrs. Rheinstrom.

We have shown before that the Revenue Act was not intended by Congress to be interpreted as it was by the Bureau in the case of appellants and that the Act itself exempts the distribution in question from tax. As suggested above, if the Act were interpreted otherwise, it would be unconstitutional. The Supreme Court in *Eisner* v. *Macomber*, 252 U. S., 189, p. 207, 64 L. ed. 521, 529, defines income as follows:

> "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets".

The Court went on to say that the Sixteenth Amendment gave Congress no right to tax capital without apportionment as required by Article 1, Section 2, Clause

3, and Section 9, Clause 4 of the Constitution, but was limited to authorizing a tax on income without apportionment, the Court saying, 252 U. S., 206, 64 L. ed. 528:

> "As repeatedly held, this (Sixteenth Amendment) did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income." (matter in parenthesis added).

The Court went on to say at the same place:

> "Congress can not by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitation alone that power can be lawfully exercised".

Clearly, therefore, as the distribution in the present case was capital in its real sense, Congress could not usurp powers not given it by the Constitution, including the Sixteenth Amendment, by the device of attempting to define it as income.

It is appellant's position that Congress did not intend to have the Revenue Act interpreted in the way sought by the Bureau in this case which would render it unconstitutional, but that the Bureau in requiring the tax from appellants was guilty of an unconstitutional abuse of its authority.

CONCLUSION

The distribution in the present case in 1934 was a payment by the corporation to appellants of an obligation to return the excess surplus created by the reduction in capital and the cancellation of the 1220 shares of common

stock in 1914, which obligation existed (1) by reason of the express understanding of the parties, and (2) by operation of law even without such express understanding. The Court below committed error in rejecting evidence as to such express understanding and in its refusal to recognize the real change in the respective rights of the shareholders which took place when the common stock was reduced and the 1220 shares cancelled. Section 115, clauses (c), (d) and (i) of the Revenue Act of 1934 expressly define the distribution made in the present case as one in partial liquidation and properly chargeable to the capital account and as such exempt from tax as no gain or loss was realized. That the distribution in question was wholly one of capital is further established by the fact that the Bureau of Internal Revenue itself recognized it as such when it revoked the proposed deficiency assessment against Adele Kiefer. Finally, as the distribution was a return of capital, it was beyond the constitutional powers of Congress to tax it as income, so that the Revenue Act of 1934 must be interpreted as exempting the distribution from tax or otherwise be unconstitutional.

It is respectfully submitted that the judgment of the court below in each of these two cases be reversed.

Respectfully submitted,

JEROME GOLDMAN,
THOMAS C. LAVERY,
Attorneys for Appellants.

A. JULIUS FREIBERG,
Of Counsel.